Nos. 12,728 and 12,729

IN THE

United States Court of Appeals

For the Ninth Circuit

ROLLINGWOOD CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DAVID D. BOHANNON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petitions for Review of Decisions of the Tax Court of the United States.

BRIEF FOR PETITIONERS.

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JURISDICTION.

Petitioner, Rollingwood Corporation, (herein called "Rollingwood") and Petitioner, David D. Bohannon (herein called "Mr. Bohannon") each separately petitioned the Tax Court of the United States for a redetermination of the following alleged deficiencies:

1. In Income Taxes of Rollingwood for the fiscal years ending:

May 31, 1944	$ 1,406.58
May 31, 1945	$11,614.26
May 31, 1947	$28,237.35
Total	$41,258.19

2. In Excess Profits Taxes of Rollingwood for the fiscal years ending:

May 31, 1945	$ 3,315.26
May 31, 1946	$ 5,171.02
Total	$ 8,486.28

Mr. Bohannon is the transferee of Rollingwood. There is no issue here involved as to his individual tax liability.

The statutory provisions upon which the jurisdiction of the Tax Court and of this Court is based are Section 272 of the Internal Revenue Code, 26 U.S.C. 272, Section 1141(a) of the Internal Revenue Code, 26 U.S.C. 1141(a), as amended by Section 36 of the Act of June 25, 1948, C. 646, 62 Stat. 991, and Section 1142 of the Internal Revenue Code, 26 U.S.C. 1142.

Rollingwood filed its Petition for Redetermination with the Tax Court on August 19, 1948, within 90 days after Respondent mailed to it Respondent's notice of deficiency upon May 25, 1948, as alleged in its petition in paragraph II (R. 6, 112), and admitted by Respondent to be true in his answer. (R. 13.)

Mr. Bohannon filed his Petition for Redetermination with the Tax Court on August 19, 1948, within 90 days after Respondent mailed to him Respondent's notice of deficiency upon May 25, 1948, as alleged in his Petition in paragraph II (R. 102, 104), and admitted by Respondent to be true in his answer. (R. 111.)

The Tax Court entered its decision that there were deficiencies in income and excess profits taxes of Rollingwood as follows:

FISCAL YEAR	INCOME TAX	EXCESS PROFITS TAX
May 31, 1944	$ 1,406.58	$
May 31, 1945	12,316.61	3,315.26
May 31, 1946		5,171.02
May 31, 1947	28,237.35	
Total	$41,960.54	$ 8,486.28

against Rollingwood on July 17, 1950; and also entered its decision that there were the same amounts of liability due from Mr. Bohannon as transferee of the assets of Rollingwood against Mr. Bohannon on July 17, 1950. (R. 79, 115.)

Both Rollingwood and Mr. Bohannon upon October 9, 1950, filed with the Tax Court, separate Petitions For Review by The United States Court of Appeals For the Ninth Circuit of these decisions of the Tax Court. (R. 91-94, 118-123.)

QUESTION PRESENTED.

Rollingwood at the request of war industry built 700 defense houses in the Spring of 1943. These houses were advertised for rent prior to their completion; the United States Government required Rollingwood to rent all of them; and upon their completion on August 14, 1943 they were all rented to war workers under a written rental agreement committing Rollingwood to the rental of each and all of these houses for a period of thirty months and, in addition, granting to each tenant of Rollingwood an option to purchase the house in which he resided. During the taxable years here involved, Rollingwood (prior to its liquidation) sold all but four of these houses:

(a) Without engaging in any sales activities;

(b) Without displaying any "For Sale" signs on any of the properties involved;

(c) Without maintaining any sales force for the purpose of selling such properties;

(d) Without paying any sales commission on the sale of said houses;

(e) Without making any sale through a broker;

(f) Without engaging in any developmental activities.

The Respondent treated gains realized upon the sale of these houses as gains from the sale of property held primarily for sale to customers in the ordinary course of business, while Rollingwood treated them as gains from the sale of properties used in its trade or business but not of properties held primarily for sale to customers in the ordinary course of its business within the meaning

of Section 117(j) of the Internal Revenue Code. The sole issue is:

Should the gains from the sale of said defense houses be treated as gains from the sale of capital assets under Section 117(j) of the Internal Revenue Code?

STATUTES AND REGULATIONS INVOLVED.

Sections 117(a) and 117(j) of the Internal Revenue Code, 26 U.S.C. 117(a) and 117(j), and Section 29.117-7 (as amended by T.D. 5394, July 27, 1944) of Regulations 111 of the Bureau of Internal Revenue are set forth in Appendix A attached hereto.

STATEMENT OF THE CASE.

In 1942 and 1943 the industrial area surrounding the City of Richmond, California, was one of the most critical war effort areas in the United States. In said area there was a very serious manpower shortage, and a very serious lack of adequate housing which resulted in a very high turnover in civilian personnel engaged in war work. (Stipulation Paragraphs 8, 9, R. 24, 25.)

Mr. Clay Bedford, the General Manager of Shipyards Numbers One and Two of the Permanente Metals Corporation, Shipyard Number Three of Kaiser Company, Inc., and Shipyard Number Four of Kaiser Cargo, Inc., (hereinafter collectively referred to as "The Richmond Shipyards") requested Mr. Bohannon to sponsor

a privately owned war housing project in Richmond. Mr. Bohannon complied with this request and organized and formed the private war housing project of Rollingwood. (Stipulation Paragraphs 7, 10, 12, 14, R. 24, 25, 26.)

During the period in which the private war housing project of Rollingwood was being arranged and constructed, it was the policy of the Federal Housing Administration to encourage private enterprises to construct privately owned defense housing facilities and to encourage the rental thereof to war workers for the purpose of providing rental housing for defense workers so that they would not have to buy a house to stay on their jobs. These policies were communicated to Mr. Bohannon, the sponsor of the Rollingwood project, prior to the inception of the project of Rollingwood. Title VI of the National Housing Act, (added to the National Housing Act by an Act of March 28, 1941, C31, 55 stat. 55, as amended by an Act of May 26, 1942, C319, 56 stat. 301, 12 U.S.C. 1736 et seq.) provided the statutory authority for the expeditious building of defense housing and contemplated increasing the availability of rental housing. (Stipulation, Paragraph 13, R. 26, 27.)

Rollingwood was organized and incorporated under California laws on January 9, 1943, to build such a private war housing project in Richmond as requested by the Richmond Shipyards. Of the 50 shares of stock issued by Rollingwood, Mr. Bohannon purchased 26 and Ross H. Chamberlain 24. On May 10, 1945, Rollingwood reacquired the shares purchased by Ross H. Chamberlain and thereafter Mr. Bohannon was the sole stockholder

of Rollingwood. (Stipulation, Paragraphs 1, 4, and 10, R. 19, 20, 25.)

On October 3, 1942 and January 14, 1943, Mr. Bohannon applied to the National Housing Agency and the War Production Board for commitments and priorities sufficient to build 700 defense houses to make possible the Rollingwood project. Although Mr. Bohannon made these applications as an individual, he did so with a view towards the subsequent incorporation of Rollingwood and the assignment to it of such commitments and priorities as he might obtain. Such priorities and commitments were issued and later assigned to Rollingwood by Mr. Bohannon. (Stipulation, Paragraphs 13, 14, 15 and 17, and Exhibits 1 and 3, R. 26-30.) Rollingwood at the time of said assignments became bound by all conditions imposed upon and all agreements made by Mr. Bohannon in connection with said priorities. (Stipulation, Forms PD-708 attached as a part of Exhibits 2 and 4.)

Some of those conditions were that:

(a) Rollingwood was required to rent all of these defense houses and to grant to each tenant an option to purchase the house in which he resided.

(b) No initial payment could be required of a Tenant except the first month's rent.

(c) The option was required to run for a period of at least 30 months.

(d) The Tenant could not be obligated to purchase.

(e) Rollingwood could not dispose of any house other than in accordance with the required lease without the

prior approval of the Director of Industry Operations, War Production Board, Washington, D.C. (Stipulation Form PD-105, Exhibits 1 and 3.)

Said 700 defense houses were begun in the Spring of 1943, and all were completed on August 14, 1943. During the entire period of construction and until all were rented, Rollingwood displayed on the construction site two large signs setting forth the rent of these houses as a rent of $50.00 per month. (Stipulation, Paragraphs 21, 23, 24, R. 32, 34, 35.)

Shortly prior to their completion, on July 31, 1943, Rollingwood advertised these houses for rent at $50.00 per month. There was no mention in said advertisement of any possibility of any sale of any of said houses. (Stipulation, Paragraph 25, R. 35.)

All of these 700 houses were rented to war workers as rapidly as they were completed. A written rental agreement was executed by Rollingwood and each of Rollingwood's tenants. Under this rental agreement, Rollingwood agreed to be bound by the rental agreement for a period of 30 months, but the Tenant only agreed to be bound on a month to month basis. Each Tenant was given an option to purchase during the continuance of the agreement, which provided that the option price therein fixed would be reduced by the surplus of rent paid in excess of loan payments. In 1944 and subsequent years, some of said houses were re-rented without any option to purchase under a written rental lease agreement. (Stipulation, Paragraph 22, and Exhibits 5, 8, and 11, R. 32-34.)

The average period that these 700 houses were in fact rented was for a period of 22.9 months. (Stipulation, Paragraphs 22 and 28, Exhibit 11 and computations therefrom, R. 32, 37, 38.)

Rollingwood during its fiscal years ending May 31, 1944, 1945, 1946 and 1947, sold respectively, to tenants who elected to exercise the option contained in the initial rental agreement 4, 46, 211 and 15 houses, and to non-tenants 28, 175, 110 and 90 houses, and to tenants to whom the houses were re-rented without any option to purchase 0, 3, 0 and 8 houses. When liquidated on May 31, 1947, Rollingwood still owned 4 houses. (Stipulation, Paragraph 28, R. 37, 38, Exhibit 11, and computations therefrom.)

Rollingwood prior to its liquidation disposed of the houses involved in these proceedings:

(a) Without engaging in any sales activities;

(b) Without displaying any "For Sale" signs on any of the properties involved.

(c) Without maintaining any sales force for the purpose of selling said properties;

(d) Without paying any sales commission on the sale of any of said houses;

(e) Without making any sale through a broker;

(f) Without engaging in any development activities. (Stipulation, Paragraphs 21 and 25, R. 32, 35, 36, Exhibit 16.)

During the taxable years here involved, Mr. Bohannon, the President of Rollingwood, devoted substantially his

entire time and energy to the private war housing projects of Rollingwood, Pacific Homes, Inc., Western Homes, Inc., and Greenwood Corporation. Prior to Pearl Harbor, Mr. Bohannon was in the real estate business and in the business of subdividing and selling real property. In addition, he was and still is the sole stock holder in Suburban Builders, Inc., which prior to December 7, 1941, was engaged in the business of a general contractor and the business of constructing and selling homes in San Mateo County, California. (Stipulation, Paragraphs 34, 35, 37, 38, R. 39, 40, 41.)

Shortly after Pearl Harbor, Mr. Bohannon disbanded his sales force, thereafter maintained no sales force, thereafter engaged in no advertising, in no land development, and in no sales programs. He caused Suburban Builders, Inc., shortly after Pearl Harbor to complete such work as it then had in progress and thereafter to undertake no further work. Mr. Bohannon did maintain his real estate broker's license during the war and at all times herein mentioned. (Stipulation, Paragraphs 35 and 36, R. 40.)

Respondent determined that the defense houses disposed of by Rollingwood were held primarily for sale to customers in the ordinary course of business and treated the gains of Rollingwood on such disposition as ordinary income.

The sole issue is whether these houses were held by Rollingwood primarily for sale to its customers in the ordinary course of its business within the meaning of Section 117(j) of the Internal Revenue Code.

SPECIFICATIONS OF ERROR.

1. The Tax Court erred in holding and deciding that the gains realized by Rollingwood from the sale of the houses involved in these proceedings were ordinary income derived from the sale of property held primarily for sale to customers in the ordinary course of business within the meaning of Section 117(j) of the Internal Revenue Code, and not gains from the sale of capital assets in accordance with the provisions of Section 117(j) of the Internal Revenue Code.

2. The Tax Court erred in not holding and deciding that the gains realized by Rollingwood on the sale of the houses involved in these proceedings should be treated as gains from the sale of capital assets in accordance with the provisions of Section 117(j) of the Internal Revenue Code.

3. The Tax Court erred in making the finding of fact (contrary to the facts stipulated to be true by Respondent and Rollingwood) that the houses involved in these proceedings were held by Rollingwood primarily for sale to customers in the ordinary course of business. Said finding of fact is erroneous because it constitutes: (a) an erroneous conclusion of law rather than of fact, and (b) the only finding or conclusion which could be made or reached upon the basis of the facts stipulated by Respondent to be true and found to be true by the Tax Court is that these houses were never held by Rollingwood primarily for sale to its customers in the ordinary course of business.

4. The decisions entered by the Tax Court herein are contrary both to the provisions of Section 117(j) of the

Internal Revenue Code and the Tax Court's findings of fact and the evidence, all of which was stipulated by Respondent to be true; and is not supported by said findings of fact or the evidence, and is in disregard of both said findings of fact and the evidence.

5. The Tax Court, in disregard of its findings of fact (i.e., the facts stipulated in writing by Respondent and Rollingwood to be true) erred in failing to include in its findings of fact and in failing to find that all houses involved in these proceedings were built and acquired by Rollingwood for rental and not primarily for sale to customers in the ordinary course of business.

6. The Tax Court, in disregard of its findings of fact (i.e., the facts stipulated in writing by Respondent and Rollingwood to be true) erred in including in its findings of fact and in finding as follows, that:

> "David D. Bohannon has for many years, including the years in question, been actively engaged in the real estate business in California."

Said finding of fact is erroneous in that it is not supported by the evidence and is contrary to and inconsistent with the other findings of fact of the Tax Court (i.e., the facts stipulated in writing by Respondent and Rollingwood to be true).

7. The Tax Court, in disregard of its findings of fact (i.e., the facts stipulated by Respondent and Rollingwood in writing to be true) erred in failing to include in its findings of fact and in failing to find that Mr. Bohannon changed his occupation shortly after December 7, 1941, from the business of building houses for sale to

the business of sponsoring and managing the construction and operation of privately owned war housing projects for rental to defense workers in which business he continued and to which he devoted substantially his entire time and attention, throughout all times involved in these proceedings.

8. The Tax Court, in disregard of its findings of fact (i.e., the facts stipulated by Respondent and Rollingwood in writing to be true) erred in failing to include in its findings of fact and in failing to find that Rollingwood (prior to its liquidation) disposed of all the houses involved in these proceedings, which were upon their construction and acquisition capital assets, without Rollingwood:

(a) ever engaging in any sales activities;

(b) ever displaying any "For Sale" signs on any of the properties involved;

(c) ever maintaining any sales force for the purpose of selling said properties;

(d) ever paying any sales commission on the sale of any of said houses;

(e) ever making any sale through a broker;

(f) ever engaging in any developmental activities.

9. The Tax Court, in disregard of its findings of fact (i.e., the facts stipulated by Respondent and Rollingwood to be true) erred in failing to include in its findings of fact and in failing to find that Rollingwood, prior to its liquidation, passively liquidated all of the houses involved in these proceedings, and that upon their acquisi-

tion and at all times thereafter they were capital assets within the meaning of Section 117(j) of the Internal Revenue Code.

10. The Tax Court erred in not holding that the deficiencies determined by the Respondent against Rollingwood and Mr. Bohannon should be redetermined so that the tax liability of Rollingwood can be established by treating the gains realized by Rollingwood on the sale of the houses involved in these proceedings as gains from the sale of capital assets within the meaning of Section 117(j) of the Internal Revenue Code.

ARGUMENT.

I. SUMMARY.

A. These cases were submitted solely upon a written stipulation of facts. There was no oral testimony. The sole issue is a matter of statutory interpretation and application and the determination of the proper conclusions of law from the stipulated record. This Court is therefore not bound by either the findings or conclusions of the Tax Court, and under the decisions of this Court, this Court will examine the stipulated record, make its own findings and reach its own conclusions.

B. In the Spring of 1943 Rollingwood acquired and constructed 700 defense houses. These houses were acquired and constructed:

(a) for rental and income producing purposes; and

(b) as a part of the housing program of the United States Government to create and make available

rental housing to in-migrant war workers in critical areas.

C. As rapidly as completed each of the 700 houses was leased to an in-migrant war worker for a period of thirty (30) months with the right in the tenant at his option to purchase.

D. On completion of the 700 houses and the entire project of Rollingwood on August 14, 1943, all of the 700 houses were so leased.

E. The average period of rental and occupancy by tenants of the houses involved in these appeals was 22.9 months per house.

F. Rollingwood advertised said houses for rent and expended $5,432.53 in such advertising.

G. The priorities issued by the United States Government pursuant to which said houses were acquired and built, prohibited the sale thereof to anyone other than the tenant without special permission of the Federal Government.

H. Rollingwood, as a corporation, was liquidated on May 31, 1947, and prior to its liquidation, it disposed of all but four of said houses under circumstances which, in view of the Court decisions construing the statute involved, including those of the Tax Court and this Court, would not convert such houses from capital assets into assets held primarily for sale to customers in the ordinary course of its business, i.e., in the sale thereof Rollingwood:

(a) never engaged in any activities to promote sales;

(b) never displayed any "For Sale" signs on any of the properties involved:

(c) never maintained any sales force for the purpose of selling said properties;

(d) never paid any sales commissions on the sale of any of said houses;

(e) never made any sale through a broker;

(f) never engaged in any developmental activities after the rental thereof.

I. Mere frequency and continuity of sales of capital assets not accompanied by any sales activities and property development will not,—under the decisions of this Court,—convert capital assets into properties held primarily for sale to customers in the ordinary course of business.

J. All of the houses here involved were capital assets when acquired and constructed and remained capital assets during the passive liquidation thereof and while Rollingwood was selling itself out of the rental business.

II. THIS COURT MAY INDEPENDENTLY AND FULLY REVIEW THE CONCLUSIONS OF THE TAX COURT BECAUSE THE ISSUE HERE IS A MATTER OF STATUTORY INTERPRETATION, I.E. A QUESTION OF LAW, AND A FUNCTION OF THIS COURT AS WELL AS THE TAX COURT.

Although it is true that in 1936, in *Richards v. Commissioner,* 81 F. 2d 369 (1936), this Court said:

> "The Board determined the ultimate fact to be: '* * * That the lots were held by the petitioner primarily for sale in the course of his business. * * *'

> We are limited therefore to an examination of the record to ascertain whether or not there is any substantial evidence to sustain the finding."

the rule of law has, however, now been settled by this Court that the findings and the conclusions of the Tax Court upon the question whether properties are held primarily for sale to customers in the ordinary course of business are subject to independent judicial review.

In *Commissioner v. Boeing,* 106 F. 2d 305 (1939), where the scope and nature of review of this court upon the question herein involved were carefully examined, this Court expressly overruled the *Richards* case and its supporting decisions on this point, and squarely held at 308:

> "'Respondent has cited decisions of the Circuit Court of Appeals, some of which are apparently in conflict with the above cited cases. He calls our attention to three decisions by our own circuit, Tricou v. Helvering, 68 F. 2d 280, 9 Cir., 1933; Winnett v. Helvering, 68 F. 2d 614, 9 Cir. 1934, and Richards v. Commr., 81 F. 2d 369, 106 A. L. R. 249, 9 Cir. 1936. But these cases must be read in light of the more recent expressions of the final court.
>
> We think that the ultimate findings of the Board above referred to in this case are conclusions of law or mixed questions of law and fact within the meaning of the Supreme Court rulings and as such are subject to independent judicial review by this Court.'" (Emphasis added.)

The question presented to this Court is the interpretation of Section 117 (j) of the Internal Revenue Code, i.e.,

whether properties were held primarily for sale to customers in the ordinary course of business, within the meaning of that Statute, and as such is obviously within the province and jurisdiction of this Court.

III. THIS COURT SHOULD REACH ITS OWN CONCLUSIONS WITHOUT REGARD TO THE FINDINGS OF FACT OF THE TAX COURT BECAUSE ALL FACTS IN THESE CASES WERE STIPULATED IN WRITING BY THE PARTIES THROUGH THEIR ATTORNEYS.

Petitioners contend that this Court has clearly settled the law as to the scope of review on the question before this Court. There is, however, an additional reason for this Court to reach its own conclusions in these cases without regard to the findings and conclusions of the Tax Court.

All of the facts in these cases were stipulated in writing by the parties through their respective attorneys. No additional evidence, by way of oral testimony or otherwise, was presented to the Tax Court at the hearing.*

The United States Courts of Appeals now review appeals from the Tax Court in the same manner in which they review cases appealed from the District Courts, sitting without juries, as a result of the amendment to Section 1141 (a) of the Internal Revenue Code, 26 U.S.C. 1141 (a), by an Act of June 25, 1948, C646, Section 36, 62 Stat. 991, which provides as follows:

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*This Stipulation, except for certain exhibits excluded from printing by the order of this Court, is printed at page 18 through page 52 of the Record.

> "(a) Jurisdiction: The courts of appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, * * * *in the same manner* and *to the same extent* as decisions of the district courts in civil actions tried without a jury; * * *." (Emphasis added.)

The Federal Courts, since the enactment in 1938 of the Federal Rules of Civil Procedure, review findings of fact in cases appealed from the District Courts, sitting without juries, in a uniform manner, whether the action is one at law or equity, in accordance with the prevailing Federal Equity practice at the time of the adoption of the Federal Rules of Civil Procedure. In *United States v. United States Gypsum Co.*, 333 U.S. 364 (1948) at page 394, the Supreme Court held that by the adoption of the Federal Rules of Civil Procedure:

> "It was intended, in all actions tried upon the facts without a jury, *to make applicable the then prevailing equity practice.*" (Emphasis added.)

The Federal Equity Courts have always drawn their own inferences from evidence which was purely documentary in character, such as where the evidence is contained in writing, or in depositions, or where the facts are stipulated in writing by the parties. Especially is this true where the facts are stipulated.*

This Court has squarely held that a full review is to be granted an appellant where all of the evidence is docu-

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*In the Federal Equity Rules of 1912, Rule 46 provided that the testimony of witnesses in equity shall be orally in open court, rather than by way of deposition, except in certain limited cases. Subsequent to this, equity adopted self denying rules of review where the testimony was orally received but the review was always full where the testimony was by way of deposition or based upon written instruments.

mentary in character by way of depositions. In *Equitable Life Assurance Society v. Irelan,* 123 F. 2d 462 (1941), where the issue was whether death by drowning was accidental or suicidal in character (purely a question of fact), and where the evidence was in the form of depositions, this Court reversed a finding of fact of the trial court, holding, at page 464:

> "Since all testimony bearing on the circumstances antecedent to and surrounding her death was by deposition, the finding of accidental death, while it is justly entitled to consideration, has not the weight we would otherwise be obliged to concede to it. This court is in as good a position as the trial court was to appraise the evidence and we have the burden of doing that. Rule 52(a) of the Rules of Civil Procedure, 28 U.S.C.A., following Section 723c, was intended to accord with the decisions on the scope of review in federal equity practice; and, as is well known, in the federal courts where the testimony in equity or admiralty cases is by deposition the reviewing court gives slight weight to the findings." (Emphasis added.)

In *Pacific Portland Cement Co. v. Food Machinery Corp.,* 178 F. 2d 541 (1949), this Court clearly expressed the general rule, as follows at 548:

> "As to this, we are faced with the mandate of Rule 52(a) of the Federal Rules of Civil Procedure, which bids us not to set aside findings unless they are 'clearly erroneous.' Federal Rules of Civil Procedure, Rule 52(a). Under the interpretation which the Supreme Court, and this and other courts of appeal, have placed upon this section, the findings of a trial judge will not be disturbed if supported by substan-

tial evidence. Full effect will always be given to the opportunity which the trial judge has, *denied to us,* to observe the witnesses, judge their credibility, and draw inferences from contradictions in the testimony of even the same witness. Savage v. Lorraine, 9 Cir., 1945, 148 F. 2d 818; Augustine v. Bowles, 9 Cir. 1945, 149 F. 2d 93, 96; Lincoln National Life Ins. Co. v. Mathisen, 9 Cir., 1945, 150 F. 2d 292, 295-296. This in the meaning of the provision that findings should not be set aside unless clearly erroneous. Grace Bros. v. Commissioner, 9 Cir., 1949, 173 F. 2d 170, 173-174. In contrast, the Supreme Court has told us that, 'A finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.' United States v. United States Gypsum Co., 1948, 333 U.S. 364, 395, 68 S. Ct. 525, 542, 92 L. Ed. 746. (Court's emphasis.)

As a corollary to this rule, we may make our own inferences from undisputed facts or purely documentary evidence. For, to use the colorful language of the Court of Appeals for the Third Circuit, the rule does not operate 'to entrench with like finality the inferences or conclusions drawn by the trial court from its fact findings.' Kuhn v. Princess Lida of Thurn & Taxis, 3 Cir., 1941, 119 F. 2d 704, 705. And see Western Union Tel. Co. v. Bromberg, 9 Cir., 1944, 143 F. 2d 288, 290; Home Indemnity Co. v. Standard Accident Ins. Co., 9 Cir., 1948, 167 F.2d 919, 922, 923." (Emphasis added.)

In a federal taxation case presented by an appeal by Joseph T. Higgins, the Collector of Internal Revenue for

the Third District of New York, the United States Court of Appeals for the Second Circuit, in *Orvis v. Higgins,* 180 F. 2d 537 (1950), Certiorari denied by the Supreme Court, 340 U. S. 810, commenting on the *Gypsum* case, supra, 333 U.S. 364, pointed out that a trial judge's finding does not have the dignity which jury verdicts derive from the Constitution nor the dignity which some statutes confer on findings of some administrative agencies, stating at p. 539:

> "In the light of the Gypsum case, we may make approximate gradations as follows: We must sustain a general or a special jury verdict when there is some evidence which the jury might have believed, and when a reasonable inference from that evidence will support the verdict, regardless of whether that evidence is oral or by deposition. In the case of findings by an administrative agency, the usual rule is substantially the same as that in the case of a jury, the findings being treated like a special verdict. Where a trial judge sits without a jury, the rule varies with the character of the evidence: (a) If he decides a fact issue on written evidence alone, we are as able as he to determine credibility, and so we may disregard his finding. (b) Where the evidence is partly oral and the balance is written or deals with undisputed facts, then we may ignore the trial judge's finding and substitute our own, (1) if the written evidence or some undisputed fact renders the credibility of the oral testimony extremely doubtful, or (2) if the trial judge's finding must rest exclusively on the written evidence or the undisputed facts, so that his evalution of credibility has no significance. (c) But where the evidence supporting his finding as to any fact issue is entirely oral testimony, we may disturb

that finding only in the most unusual circumstances." (Emphasis added.)

The United States Court of Appeals for the District of Columbia, in *Dollar v. Land,* 184 F. 2d 245 (1950), clearly followed the *Orvis v. Higgins* decision, supra, 180 F.2d 537. There the Court reversed a finding by the District Court that the transfer of the stock of the Dollar Steamship Lines to the United States Maritime Commission was absolute and not by way of pledge, *granting a full review* where the finding was based upon documentary evidence or undisputed facts.

In *Wigginton v. Order of United Commercial Travelers,* 126 F.2d 659 (1942), certiorari denied, 317 U.S. 636, where all facts were stipulated, the Circuit Court of Appeals for the Seventh Circuit, at page 661, held:

> "Since the facts are not in dispute, we are free to consider them and to reach our own conclusion, untrammeled by the District Court's findings and conclusions of law. Especially is this rule applicable in the case at bar, where all the facts are stipulated." (Emphasis added.)

The only dispute between the parties here is with respect to the inferences or conclusions to be drawn from undisputed facts, i.e., facts which were stipulated, found to be true by the Tax Court, and included within the Tax Court's Findings of Fact. This disputed Conclusion is whether or not these houses were held primarily for sale to customers in the ordinary course of business within the meaning of section 117(j) of the Internal Revenue Code.

Where the facts are undisputed, and the only question is as to the application of the statute, this conclusion is

a matter of statutory interpretation and a proper function of this Court. The Tax Court's inclusion of a finding of fact to this effect in its findings cannot deprive petitioner of the consideration by this Court of whether or not the statute is applicable.

But assuming solely for argumentative purposes that there is any element of fact contained in the Tax Court's decision, this Court is free to draw its conclusions in accordance with the uniform federal equity practice from facts which are both (a) undisputed evidentiary facts and (b) are entirely set forth in a written Stipulation of Facts.

IV. THE HOUSES INVOLVED IN THESE CASES WERE NOT BUILT OR ACQUIRED PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF BUSINESS BECAUSE THEY WERE BUILT AND ACQUIRED FOR RENTAL.

A. Rollingwood announced and advertised that these houses were for rent during the entire period of their construction.

During the entire period of construction of the defense houses built by Rollingwood and until all were rented (a period of several months), Rollingwood displayed on the site of this war housing project, in a conspicuous location, two large signs setting forth the rent of these houses as a rent of $50.00 per month. (Stipulation, Paragraphs 23, 24, R. 34, 35).

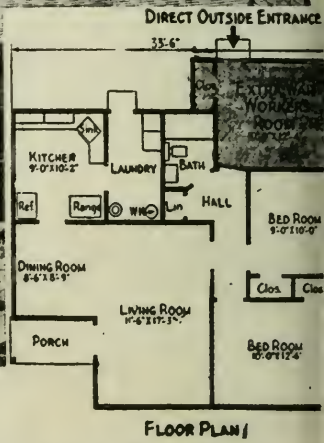
These signs were of dimensions greater than 2½ feet by 4 feet and of such a character that the words *therein were legible at a distance of 100 feet.* (Stipulation, Paragraphs 23, 24, R. 34, 35).

Homes for War Workers

NOW AVAILABLE IN

ROLLINGWOOD

THE MODEL COMMUNITY OF RICHMOND



FLOOR PLAN

- For Rent—$50 a Month New 3 Bedroom Homes
- Regular Bus Service To Shipyards
- School Nearby
- Fully Landscaped
- Restricted

Childhood Gets No Second Chance --- ACT NOW!

Call at our Office, West Side of Ninth Street, between Macdonald Avenue and Nevin, opposite Kaiser Hiring Hall. Courteous Attendants Will Drive You to the Rollingwood Tract, Located Near Intersection of Twenty-third and San Pablo Avenue, Richmond.

ROLLINGWOOD CORP.

TELEPHONE RICHMOND 4448

B. Prior to the completion and the rental of all of these houses Rollingwood advertised these defense houses for rent.

On July 31, 1943 (approximately two weeks before the completion of all of said houses) Rollingwood advertised said houses for rent by an advertisement (Stipulation, Paragraph 25, Exhibit 9, R. 35, 52), which for convenience petitioners have reprinted opposite:

In said advertisement there was no mention whatsoever of any possibility of any sale of any of said houses. The announced and advertised intention of Rollingwood with respect to these houses was that they were only "For Rent". This intention was so manifested at a time when petitioners were obviously concerned with building houses as rapidly as possible as their contribution to the war effort and not with any tax consequences of their acts.

C. A most critical war industry, and not petitioners, initiated this defense housing project.

The Mare Island Navy Yard, Shipyards Numbers One and Two of the Permanente Metals Corporation, Shipyard Number Three of Kaiser Company, Inc., and Shipyard Number Four of Kaiser Cargo, Inc. (known collectively as the "Richmond Shipyards") were in operation in the Richmond industrial area when this project was requested. In addition, said area, included refineries of the Standard Oil Company of California, Shell Oil Company and Union Oil Company, the Hercules Powder Company, and numerous other essential war industrial enterprises. (Stipulation, Paragraph 7, R. 24).

Mr. Clay Bedford, the General Manager of the Richmond Shipyards, requested Mr. Bohannon to sponsor the defense housing project which was constructed by Rolling-

wood. At the time of his request he knew of the defense housing project at Napa, California, which Mr. Bohannon had also sponsored and managed. He advised Mr. Bohannon that he could make no greater contribution to the war effort than to sponsor the requested defense housing project. In that connection Mr. Bedford advised Mr. Bohannon that:

> "* * * if adequate war housing were made available, it would substantially lessen the serious loss of leadermen and key personnel in the Richmond Shipyards which was being experienced at that time, and that at that time the Richmond Shipyards were bringing workmen from various parts of the United States to Richmond and that due to the lack of housing such workmen would not bring their families and would not themselves stay in the City of Richmond." (Stipulation, Paragraph 10, R. 25).

D. This project was undertaken and completed in accordance with the policy of the United States Government to encourage the construction of defense houses for rent.

At the time this project was initiated and organized, it was the policy of the Federal Housing Administration to encourage private enterprises to construct privately owned defense housing facilities and to encourage the rental thereof to war workers for the purpose of providing rental housing for defense workers so that they would not have to buy a house to stay on their jobs. This policy was communicated to Mr. Bohannon by officials of the Federal Housing Administration prior to the inception of the Rollingwood project.

Title VI of the National Housing Act, (added to the National Housing Act by an Act of March 28, 1941, C31, 55 Stat. 55 as amended by an Act of May 26, 1942, C319,

56 Stat. 301, 12 U.S.C. 1736 et seq.) provided the Congressional Authority for expediting defense housing and contemplated increasing the availability of rental properties. (Stipulation, Paragraph 13, R. 26, 27).*

To make possible the proposed Rollingwood war housing project, it was necessary to obtain the approval of the National Housing Agency and to obtain from the War Production Board priorities for all critical building materials necessary for said project. (Stipulation, Paragraphs 11, 14, R. 26, 27.)

Mr. Bohannon made two applications to the War Production Board for the necessary priorities covering the critical materials required in the construction of the 700 houses here involved. Although Mr. Bohannon made these applications as an individual, he did so only with the intention of the subsequent incorporation of Rollingwood and the assignment to it of such commitments and priorities as he might obtain. The first application was filed October 3, 1942, with respect to 400 houses, and the second application was filed January 14, 1943, with respect to 300 houses. (Stipulation, Paragraphs 14, 15, 17 and Exhibits 1 and 3, R. 27, 28, 29, 30.)

Both applications were processed and approved by the National Housing Agency (acting through the Federal Housing Administration) and by the War Production Board. (Stipulation, Paragraphs 15, 17, R. 28, 29, 30.)

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*Pursuant to Congressional Authority, on February 24, 1942, Executive Order No. 9070, 50 U.S.C.A. App. Section 601, page 206, 7 F.R. 1529, consolidated the major agencies dealing with housing, including the Federal Housing Administration, into a National Housing Agency to be administered by a National Housing Administrator. One of the three main units of this agency was the Federal Housing Administration administered by the Federal Housing Commissioner.

E. The conditions imposed by the United States Government on the issuance of said priorities necessitate a finding that said houses were built and acquired for rental and not primarily for sale to customers in the ordinary course of business.

Rollingwood was bound by all conditions imposed upon Mr. Bohannon and all agreements made by him in connection with the issuance of said priorities. (Stipulation, Forms PD 708 attached to and forming a part of Exhibits 2 and 4.)

By reason of said conditions and agreements:

1. Rollingwood was required to rent said houses and to grant to each tenant an option to purchase.

2. No initial payment could be required of a tenant, except the first month's rent.

3. No monthly payment could exceed rental for equivalent accommodations.

4. A period of at least 30 months was required to be given to the tenant to accumulate an equity to apply on the option price of the house in which he resided.

5. The tenant *could not be obligated to purchase.* (Stipulation Forms PD-105, Exhibits 1 and 3.)

F. The actual renting of all of said houses by Rollingwood, the manner in which it rented said houses and the manner in which it conducted its business necesitate a finding that said houses were built for rental and not primarily for sale to customers in the ordinary course of business.

These houses were begun in the Spring of 1943 and all were entirely completed and ready for occupancy on August 14, 1943. Rollingwood as rapidly as possible as each house was completed then in fact rented every one of

ADDITIONAL PROVISIONS

1. The property covered by this agreement is described as follows:

2. If the dwelling on the property is under construction at the time this agreement is executed, the rental shall commence on the date that Rollingwood Corp. can deliver possession of the property.

3. No alterations of any kind to the dwelling shall be made without the prior written consent of Rollingwood Corp.

4. The renters shall pay for all utility services furnished to the property.

5. The renters shall keep the property in first-class condition and shall pay for all repairs.

6. The renters shall not have the right to sublet the property or to assign this agreement or any interest in the property without the prior written consent of Rollingwood Corp.

7. The FHA payments referred to herein shall include all payments made on account of principal, interest, fire insurance, taxes, FHA mortgage insurance and all other FHA charges.

8. The option to purchase granted to the renters, shall be conditioned upon the renters being acceptable to the FHA as borrowers in lieu of Rollingwood Corp. and shall be subject to any conditions imposed by the War Production Board.

9. The option to purchase shall expire on the first to occur of the following: (a) surrender of possession by the renters; or (b) the expiration of thirty months from date; or (c) default by the renters which remains unremedied for ten days after notice given to the renters by mail addressed to them at No. ..... Avenue, Rollingwood, Calif.

10. Rollingwood Corp. shall have the right to inspect homes at any time.

Furthermore, Rollingwood Corporation had by this form of agreement committed all of said 700 houses to rental for the period of 30 months.

G. The granting of an exclusive option to purchase to the occupant of each house itself strengthens the conclusion that Rollingwood was not primarily interested in the sale of these houses.

As each of the 700 houses was completed and rented each tenant was granted an exclusive option lasting for 30 months to purchase the house in which he resided. (Stipulation, Paragraph 22, Exhibit 5, R. 32, 49.) This exclusive option eliminated from the entire field of potential purchasers all but the single occupant residing in each house and thus restricted the market of potential purchasers to a single person.

If Rollingwood were primarily interested in the sale of these houses, it seems inconceivable that it would have placed itself in a position where it could not sell any house except to the single tenant residing therein and only in the event of his desire to purchase (except for a purely theoretical sale subject to the option).

Especially is this true when as here the tenants of Rollingwood were in-migrant war workers,* a class from whom it could hardly have been forecast by Rollingwood at a date early in World War II, that many potential purchasers would come. (Stipulation, Paragraph 22, R. 32.)

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*In-migrant war workers were those war workers whose in-migration from beyond the distance of feasible transportation into localities of intensive war production was indispensable to augment the local labor supply. See National Housing Agency Order 60-1, Sections 1.02 and 3 set forth in Exhibit 12.

H. These houses were rented for an average period of 22.9 months.

The approximate length of time which each of these houses was in fact rented is set forth on Exhibit 11. Based on a pure mathematical computation, the average period during which these houses were in fact rented was 22.9 months. This is a *substantial* period of rental which should not be disregarded and which conclusively shows that Rollingwood carried out and fulfilled its purpose of building and acquiring houses for rental.

Petitioners submit that the evidence hereinabove discussed makes it abundantly clear that Rollingwood built and acquired these houses for rental, that it placed the possession, use, and ability to sell these houses beyond its power for a period of thirty months.

I. Not only was Rollingwood a project for the building of houses for rental but, also, Mr. Bohannon during the war discontinued all of his personal activities in land development, all of his sales programs, and all of his sales activities.

It is true that prior to December 7, 1941, Mr. Bohannon was in the real estate business primarily in the County of San Mateo, State of California. Shortly after December 7, 1941, however, he disbanded his sales force and thereafter maintained no sales force. He thereafter engaged in no advertising, and in no land development and in no sales programs. (Stipulation, Paragraphs 34, 35, R. 39, 40.)

In addition to the discontinuance of all of his personal activities with respect to land development, he caused Suburban Builders, Inc., which prior to December 7, 1941 had been in the business of building houses for sale, to

discontinue all of its building of homes and sales activities. Thereafter he devoted his entire time and attention to the private war housing project of Rollingwood and other private war housing projects. (Stipulation, Paragraph 35, R. 40.)

No doubt the Respondent will attempt to taint Rollingwood with Mr. Bohannon's pre-war activities, and the fact that Mr. Bohannon kept in force during the war his brokerage license.

Any finding that Rollingwood was holding these houses primarily for sale to customers in the ordinary course of business must of necessity have been based on inferences from facts not within this record, and contrary to the facts stipulated to have been true. Not only are Rollingwood and Mr. Bohannon separate taxable entities, but Mr. Bohannon himself in his personal business discontinued during World War II, and all times material to these proceedings, all aspects of his pre-war real estate and land development activities. During this time he devoted himself exclusively to private war housing projects such as the Rollingwood Project.

Rollingwood announced and advertised that these houses were for rental; it entered into written rental agreements with respect to each and every house; it granted to each of its tenants an exclusive option to purchase the house in which he resided; it placed the possession, control and ability to sell these houses beyond its power for a period of thirty months. These facts make it abundantly clear that Rollingwood built and acquired these houses for rental.

V. THESE HOUSES WERE NEVER HELD PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF BUSINESS BECAUSE THE MERE FREQUENCY AND CONTINUITY OF SALES OF CAPITAL ASSETS BY ITSELF HAS NEVER BEEN HELD TO BE SUFFICIENT TO CHANGE THE CHARACTER OF CAPITAL ASSETS INTO ASSETS HELD PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF BUSINESS.

A. **The sale of these houses which the evidence conclusively shows to have been built for rental rather than to have been built primarily for sale to customers in the ordinary course of business was accompanied by no extended development—in fact, no development and no sales activities of any kind.**

It was stipulated in the Stipulation of Facts that all development work was completed on August 14, 1943. (Stipulation, Paragraphs 6 and 21, R. 23, 32.) Paragraph 21 of the Stipulation of Facts (R. 32) reads as follows:

> "The work of preparing the Rollingwood Tract for use in said project of Rollingwood Corporation and the work of constructing and completing said seven hundred (700) houses was commenced during the Spring of 1943, and all of said seven hundred (700) houses were completed on August 14, 1943, the entire project having been fully performed within six hundred ninety-three (693) elapsed working hours after the first ground breaking on the Rollingwood Tract." (Emphasis added.)

Since, therefore, all subdivision work, all construction work and all development work was completed on August 14, 1943, there was nothing remaining for Rollingwood to do in the development of its properties and on that date every house was rented for thirty (30) months.

Rollingwood rented each and all of said 700 houses and committed itself to the rental of each thereof for a period

of thirty months. By taking the entire period of all rentals and dividing the same by the number of houses, it appears that said 700 houses were rented for an average of 22.9 months each.

Rollingwood did not thereafter engage in any sales activities or in any development of its properties which, under the decisions, would justify any holding except a holding that its properties were upon their acquisition and at all times thereafter capital assets.

Rollingwood at no time displayed any "For Sale" signs on any of the houses involved in these cases. (Stipulation, Paragraph 25, R. 35, 36.)

Rollingwood never displayed any "For Sale" signs on the Rollingwood Tract. (Stipulation, Paragraph 5, R. 35.)

Rollingwood never had any sales force for the purpose of selling said houses. (Stipulation, Paragraph 25, R. 35.)

Rollingwood never paid any sales commission on the sale of any of said houses. (Stipulation, Paragraph 25, R. 35, 36.)

Rollingwood never made any sale whatsoever through a broker, (Stipulation, Paragraph 25, R. 36) and all sales were handled by Rollingwood's manager and his assistants who were enployed on a salary basis.

Rollingwood, following the completion of the construction of its project on August 14, 1943, never engaged in any developmental activities with respect to the Rollingwood Tract, or said project. (Stipulation, Paragraphs 6, 21, R. 23, 32.)

After the completion of these houses and its private war housing project on August 14, 1943, Rollingwood never subdivided, improved or in any other way developed its properties. (Stipulation, Paragraph 21, R. 32.)

B. Rollingwood expended more than $5000 in advertising said houses for rental.

It is stipulated in "Exhibit 16" of the Stipulation of Facts that Rollingwood expended in advertising said houses for rental the following amounts:

Fiscal Year Ended May 31	Amount For Such Fiscal Year
1944	$4,442.97
1945	989.56
1946	0
1947	0

All of said advertising expenses were included in rental expenses and charged against Rollingwood Corporation's gross rental income. (Stipulation, "Exhibit 16", Paragraph 30, R. 39.)

It is inconceivable that a corporation, holding real property primarily for sale to customers in the ordinary course of business, would have expended $5,432.53 in advertising its properties for rent, or that it would have published the advertisement set forth as "Exhibit 9" of the Stipulation of Facts and at page 25 of this Brief.

C. The courts have only applied the frequency and continuity tests to convert an asset which is acquired as a capital asset into an asset held primarily for sale to customers in the ordinary course of business where substantial developmental or sales activities accompanied such sales.

In the leading case decided by this Court of *Richards v. Commissioner,* 81 F. 2d 369 (1936), properties which

were acquired and purchased as farming property, i.e. clearly capital assets upon their acquisition, were held to have been converted into assets held primarily for sale in the course of business by a sub-division of those properties by the taxpayers. The Court stated at 370:

> "Petitioner concedes that he subdivided his real property and held it thereafter primarily for sale, * * *"

Commenting on the effect of such a subdivision, this Court said at 373:

> "It is quite obvious that the reason petitioner subdivided the land for sale was to obtain a larger profit."

Although the word "held" includes properties which at one period were capital assets and which have had their classification changed subsequent to their acquisition to that of property held primarily for sale to customers in the ordinary course of business, petitioners vigorously urge that this Court has never indicated or held that nothing more than a mere frequency and continuity of sales is needed for such a conversion.

In the other leading case in this field, *Ehrmann v. Commissioner,* 120 F. 2d 607 (1941), taxpayers again were held to have changed the character of capital assets into assets held primarily for sale to customers in the ordinary course of business by a subdivision.

Furthermore, both of these cases involved typical Southern California subdivision trusts where extensive selling activities were entrusted to exclusive real estate sales agents. The contract between the owners and the real estate agents in the *Ehrmann* case provided for a

selling commission of 28% of the gross sales price to be paid the agent. In return it agreed to "* * * organize and train an efficient sales organization to carry on an extensive and intensive advertising and selling compaign, * * *" (From the Findings of Fact of the Board, 41 BTA 652, at 657.) (Underscoring added.)

In the *Richards* case, supra, 81 F.2d 369, the taxpayer subdivided his property into about 400 lots. He employed an exclusive sales agent—a real estate man who was to subdivide the property, and was to solicit and obtain purchasers. The taxpayer agreed to pay him real estate commissions out of which he was to pay advertising and selling expenses of himself and his subagents. (30 B. T. A. 1131, at 1133.) (Underscoring added.)

In the article entitled: "When does a Seller of Real Estate Become a Dealer" in the 1950 University of Southern California Tax Institute (p. 325), Mr. Lucien W. Shaw, the author, discusses these cases and emphasizes that all Courts, including this Court, have never held a mere frequency and continuity of sales of properties acquired as capital assets by itself to be sufficient to convert such capital assets into assets held primarily for sale to customers in the ordinary course of business, where the sale of such assets is unaccompanied by any developmental or sales promotional activities.

There is no substantial basis for a contention that a taxpayer should be entitled to reap the business profit obtained in disposing of capital assets by means of a sale thereof only after extensive and intensive activities, to wit: subdividing, intensive and extensive advertising for

by the petitioners. The respondent there made exactly the same argument he is making in these cases. The Tax Court rendered a decision for the petitioners, holding that:

> "The facts here * * * also indicate that the sales in question appear to have been essentially in the nature of a gradual and passive liquidation without 'extensive development' and 'sales activity'. In the *Farley* case, in dealing with *Ehrman v. Commissioner*, supra, and *Richards v. Commissioner*, 81 Fed. (2d) 369 [17 AFTR 360], both cited by respondent, we said that where the liquidation of an estate is accompanied by extended development and sales activity the mere fact of liquidation will not be considered as precluding the existence of a trade or business. In the absence of these elements, however, we held that liquidation could not be disregarded, and hence in the *Farley* case we held that profits derived from sales were taxable as long term capital gains. Approval of the Tax Court's reasoning and result in the Farley case was expressed by the Fifth Circuit in their opinion in White v. Commissioner, 172 Fed. (2d) 629 [1949 P. H. Paragraph 72,346 (C.C.A. 5).]" (Underscoring added.)

The *Dagmar Gruy* case shows that the frequency and continuity of sales is not by itself sufficient to change the character of property built and rented, i.e., capital assets, into assets held primarily for sale to customers in the ordinary course of business and that merely selling capital assets is by itself insufficient to convert such assets into assets held primarily for sale in the ordinary course of business.

The late decision of *A. Benetti Novelty Co., Inc.*, 13 T.C. 1072 (Dec. 22, 1949) is an excellent illustration of the principle here asserted. There the petitioner acquired a large number of slot machines prior to the war for rental to its customers. During the war a wartime scarcity of slot machines arose. The demand became very great from the U. S. Armed Services for slot machines for service clubs. The petitioners was requested by the Army and Navy to obtain as many slot machines as possible. The petitioner bought up all the machines it could find in Nevada and the surrounding states. Instead of selling these new machines to the U. S. Armed Services, petitioner retained most of them for use in its business. It repaired and rehabilitated many of the machines it had rented. These repaired and rehabilitated machines it sold to the Armed Services and other purchasers during the taxable years 1943, 1944 and 1945. As to the machines bought for resale during this period and resold without having been rented, petitioner admitted the gain derived was ordinary income from the sale of property held primarily for sale to customers in the ordinary course of business. The issue before the Tax Court was whether the gain on the machines which had been rented and thereafter sold was taxable as capital gain or as ordinary income.

In the taxable years in question—1943, 1944 and 1945—petitioner sold 391 slot machines.

The Tax Court rejected Respondent's determination that said slot machines which had been rented and then sold were held primarily for sale to customers in the ordinary course of business. The Tax Court held for the petitioner, stating at 1078 that:

> "It thus seems that the gains in issue were derived from sales of machines which were originally purchased and held for rental purposes only." (Underscoring added.)

The Court reached this decision despite the fact that in the *A. Benetti Novelty Co., Inc.*, case (as was also true in the *Elgin Building Corporation* case ..... T.C. .....; Para. 49,015, P-H TC Memo. 1949 infra, at p. 45), the left hand of the taxpayer was engaged in the business of selling property held primarily for sale to customers in the ordinary course of business.

Since in these cases, Rollingwood sold only property which it acquired and built for rental and which it in fact rented for an average of 22.9 months per house, Rollingwood is in a position immeasurably stronger than that of petitioner in the *A. Benetti Novelty Co., Inc.*, case.

To the same effect is the decision of the United States Court of Appeals for the Fifth Circuit in *Fahs v. J. T. Crawford,* 161 F. 2d 315 (1947). In that case the taxpayers were held to have passively sold lots from an existing subdivision in a manner whereby they did no more than to receive the purchase price and execute the deeds. The Court held that a verdict was properly directed for the taxpayer, stating at page 317:

> "In essence, the taxpayer here has done no more than hold land purchased by him as an investment, qualify it for FHA loans so that it would sell, and accept the purchase price and execute deeds therefor as it was purchased or sold by Commander. This is not enough to put the taxpayer into the real estate business. It amounts to no more than converting a capital asset into cash." (Underscoring added.)

These cases should be contrasted with the converse situation—where property originally acquired as an investment is sold with substantial developmental and advertising activities, accompanied by the payment of real estate commissions, i.e., such as the subdivisions involved in *Richards v. Commissioner,* 81 F. 2d 369, and *Ehrman v. Commissioner,* 120 F. 2d 607. In either of these situations the capital gain treatment is not permitted the taxpayer because his business activities in the disposition of his properties are held to be sufficient to convert capital assets into assets held primarily for sale to customers in the ordinary course of business. In the case of *R. H. Hutchinson,* .....T.C....., Para. 49,155 P-H TC Memo. (1949), the taxpayer acquired an eight acre tract of land intending to use one-half for a factory site and to sell the rest in one transaction. He abandoned this purpose and subdivided the property. His sales of lots were accompanied by extensive advertising and sales activities. The Tax Court rejected the contention of the taxpayer that he was passively liquidating property and held that his activities in the disposition of this property prevented the application of the clearly established doctrine that where a taxpayer passively liquidates capital assets, his sales of property will not be held to be sales in the ordinary course of business of property held primarily for sale to customers.

The exception from the capital gain treatment of the sales of property held primarily for sale to customers in the ordinary course of business is applicable to property which a merchant holds for sale to the public and which a dealer holds for sale to his customers. Because of the

increment in profit and the different financial result due to the "business" manner in which the sales are conducted, their income is treated like income from personal services, rents and the like. But in the absence of any business activities and consequently in the absence of the business profits attributable to such activities, the capital asset treatment should not be denied a taxpayer merely because it sells itself out of the business of renting homes.

E. Cases relied on by the Tax Court which hold that assets built and acquired primarily for sale are not converted into capital assets by the mere rental thereof are not in point in this case because these houses were built and acquired for rental.

The Tax Court relied on *Neils Schultz,* 44 B.T.A. 146, *Charles H. Black Sr.,* 45 B.T.A. 204 and *Walter G. Morley,* 8 T.C. 904, for the proposition that the rental of these houses did not preclude them from being considered houses held primarily for sale to customers in the ordinary course of business.

In all of those cases, however, the properties involved were expressly found to have been built for sale, and the holding was only that incidental rental of these properties would not convert them into capital assets.

In the cases before this Court, the facts conclusively show that the houses involved were built, not primarily for sale to customers in the ordinary course of business, but for rental and thus the cases relied upon by the Tax Court are not in point.

Rollingwood Corporation *built* these houses for rental. It placed the possession, use and control of each and every house beyond its power for a period of thirty months.

When Rollingwood sold these houses it passively liquidated capital assets and itself went into liquidation shortly thereafter.

VI. ON FACTS FAR LESS FAVORABLE TO THE TAXPAYER THAN THOSE NOW BEFORE THIS COURT, THE TAX COURT DECIDED THAT HOUSES WERE NOT HELD PRIMARILY FOR SALE TO CUSTOMERS IN THE ORDINARY COURSE OF BUSINESS.

Under strikingly similar facts, but facts which were less favorable to the taxpayers than those now before this Court, the Tax Court itself reached the conclusion that houses so built and rented, should not be considered as property held primarily for sale to customers in the ordinary course of business. *Elgin Building Corporation* (1949) ..... T.C. ....., Para. 49,015 P-H TC Memo. 1949. Uniformity of taxation among taxpayers of the same general class under almost identical facts has absolutely no meaning, if the Elgin taxpayers are to be treated by the Tax Court in one way and Rollingwood in another.

The alleged deficiency which the Commissioner of Internal Revenue has asserted against Rollingwood Corporation was determined by the Commissioner in 1948, and *prior to the decision in the Elgin case,* which was rendered by the Tax Court on February 15, 1949.

We submit that the facts in the cases now before this Court are not capable of distinction from the facts in the *Elgin* case, and we will await with interest such attempts as Respondent may make to suggest any grounds of distinction.

In the *Elgin* case and in the cases now before this Court:

1. There was an acute housing shortage in critical war production areas. (Stipulation, Paragraphs 8 and 9, R. 24, 25.)

2. The policy of the United States Government (Federal Housing Administration) was communicated or known to the taxpayers, i.e., the policy of encouraging the construction of defense houses for rental purposes "to provide rental housing for defense workers so that they would not have to buy a house in order to stay on the job." (This quotation and all other quotations in this enumeration are, unless otherwise noted, from the opinion of the Tax Court in the *Elgin* case.) (Stipulation, paragraph 13, R. 26, 27.)

3. The taxpayers were requested to undertake their projects either by officials of the United States Government or critical war industry. (Stipulation, Paragraph 10, R. 25.)

4. Three separate corporations were formed by the sponsors of the Elgin projects, and Mr. Bohannon sponsored Rollingwood, the only corporation here involved, and three other corporations which are not involved in these cases. All corporations herein referred to were organized with a view to projects under Title VI of the National Housing Act. (Stipulation, Paragraphs 13, 35, 37, 38, R. 26, 40, 41, 42.)

5. Title VI of the National Housing Act, as stated in the *Elgin* case, "contemplated increasing the availability of rental properties * * *" which is stipulated to have

been true in these cases. (Stipulation, Paragraph 13, R. 26, 27.)

6. In *Elgin,* the sponsors or their affiliates advanced funds to their corporations. In the cases now before this Court Mr. Bohannon and one of his associates executed to Bank of America National Trust & Savings Association a continuing guarantee, guaranteeing loans to Rollingwood in the aggregate amount of $4,000,000.00 under which the guarantors were liable for 700 Federal Housing Administration Loans and $600,000.00 of open credit extended to Rollingwood. (Stipulation, Paragraphs 26 and 27, and Exhibit 10, R. 36, 37.)

7. The financing through the Federal Housing Administration, the supervision thereby of the building sites and of the plans and specifications and of the insurance of loans by the Federal Housing Administration were the same in the *Elgin* case as here. (Stipulation, Paragraphs 13, 26 and 27, R. 26, 36, 37.)

8. The applications to the War Production Board for priorities imposed substantially the same conditions upon and exacted substantially the same agreements both in the *Elgin* case and in the cases now before this Court. (Stipulation, Paragraphs 15 and 17, and Exhibits 1, 2, 3 and 4, R. 28, 29.)

9. The same General Orders of the National Housing Agency were applicable, and in neither the *Elgin* case nor in the cases now before this Court were any applications made to the Government for permission to sell. (Stipulation, Paragraph 29, Exhibits 12, 13, 14 and 15, R. 38.)

10. In the *Elgin* case 235 houses were built by the corporations there involved. Rollingwood built 700.

11. In the *Elgin* case "many of the houses were sold by the corporations either to tenants who occupied the houses or to non-tenants when the houses were vacant." All sales by Rollingwood were so made. (Stipulation, Paragraph 28, R. 37, Exhibit 11.)

12. No "For Sale" signs were ever displayed on the *Elgin* houses. No "For Sale" signs were ever displayed on either the Rollingwood houses or on the Rollingwood tract. (Stipulation, Paragraph 25, R. 35, 36.)

Not only do the *Elgin* case and the case now before this Court involve strikingly similar facts, but in addition the facts now before this Court are much stronger in favor of the petitioners in these respects:

1. In the *Elgin* case "most of the houses were sold by real estate brokers," whereas Rollingwood did not sell a single house through a real estate broker. (Stipulation, Paragraph 25, R. 35, 36.)

2. In the *Elgin* case (based upon the schedules set forth in the Tax Court's decision) more than 27% of the houses were sold without ever having been rented, whereas

Rollingwood immediately rented every house constructed by it under an agreement that committed Rollingwood to the rental of every house for 30 months. (Stipulation, Paragraph 22, R. 32, 33.)

3. In the *Elgin* case (based only upon the houses actually rented as shown by the schedules set forth

in the Tax Court's decision) the average period of rental per house rented was 15.39 months, whereas

The average period of rental of Rollingwood's houses was 22.9 months per house. (Computation based on Stipulation, Paragraph 28, Exhibit 11, R. 37, 38.)

4. In the *Elgin* case there was no evidence of any advertisement "For Rent" whereas

In the cases now before this Court Rollingwood, prior to completion of its houses published the advertisement "For Rent," of which a photostatic copy is included in the Stipulation of Facts and in this Brief, and during the entire period of construction and until all of its houses were rented and beyond its control for a period of 30 months Rollingwood maintained signs on its tracts stating that said houses were "For Rent" for $50.00 per month. (Stipulation, Paragraphs 23, 24, and 25, Exhibit 9, R. 34, 35, 36, 52.)

In the *Elgin* case that portion of the houses that were sold without ever having been rented at all were properly determined to have been property held by the Elgin taxpayers primarily for sale to their customers in the ordinary course of their business. From this it necessarily follows that the Elgin taxpayers were in the business of building houses primarily for sale to their customers in the ordinary course of their business. Yet, notwithstanding the existence of such business in the left hand of the Elgin taxpayers, the Tax Court felt compelled to hold, and did hold that the right hand of the Elgin taxpayers—with

respect to all houses that had once been rented—was disposing of properties not held primarily for sale to their customers in the ordinary course of their business.

This demonstrates, we submit, the unanswerable fact that the position of the taxpayers now before this Court is immeasurably stronger than that of the Elgin taxpayers. Rollingwood rented every house and rented every house under an agreement that, when executed, placed the possession and use and control of every house beyond the power of Rollingwood for a period of 30 months.

The following quotation from the opinion in the *Elgin* case, we submit, disposes of the contention of the Commissioner and sets forth the Tax Court's interpretation of Section 117(j) which is equally applicable in the cases now before this Court:

> "Under petitioners' commitments, if a house was once rented, it could not be sold unless the tenant exercised his option to purchase or an outsider bought subject to the tenant's rights. As to all of those properties, we agree that this circumstance stamped their primary purpose as rental or income-producing housing; and that they were capital assets under Section 117(j)."

This case illustrates explicitly the principle that the mere frequency and continuity of sales of capital assets is not by itself sufficient to change properties from capital assets to assets held primarily for sale to customers in the ordinary course of business.

VII. CONCLUSION.

We respectfully submit that the decisions of the Tax Court entered in these cases, were erroneous, and we respectfully request that this Court reverse those decisions in accordance with the prayer of the Petitions For Review by this Court.

Dated, San Francisco, California,
February 12, 1951.

Respectfully submitted,
JUSTIN M. JACOBS,
GARRET MCENERNEY II,
JAMES SHAUGHNESSY,
Counsel for Petitioners.

(Appendix A Follows.)

Appendix A.

Appendix A

STATUTES AND REGULATIONS INVOLVED.

Internal Revenue Code Section 117 Capital Gains and Losses (As applicable to years 1943, 1944, 1945, 1946 and 1947).

"(a) *Definitions.*—As used in this chapter.

(1) *Capital Assets.*—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property used in the trade or business of a character which is subject to the allowance for depreciation provided in Section 23 (1), or an obligation of the United States or any of its possessions, or of a State or Territory or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer."

. . . . . .

"(j) *Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*

(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term 'property used in the trade or business' means

property used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23 (l), held for more than six months, and real property used in the trade or business, held for more than six months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion."

. . . . . .

Regulations 111 of the Bureau of Internal Revenue:

Section 29.117-7 (as amended by T. D. 5394, July 27, 1944)

"*Gains and Losses From Involuntary Conversions and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—Section 117(j) provides that the recognized gains and losses

(a) from the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than 6 months, which is

(1) of a character subject to the allowance for depreciation provided in Section 23 (1), or

(2) real property,

provided that such property is not of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or is not held by the taxpayer primarily for sale to customers in the ordinary course of trade or business, and . . ."